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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 004893

SIPDIS

E.O. 12958: DECL: 12/04/2015

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SUBJECT: AMBASSADOR DISCUSSES BUDGET, BANK RESTRUCTURING,
ARAB LEAGUE BOYCOTT WITH MINISTER OF FINANCE

REF: BAGHDAD 3132 (NOTAL)

Classified By: Ambassador Zalmay Khalilzad for reasons 1.4 (b) and (d).

1. (C) SUMMARY: Ambassador urged Minister of Finance Allawi on December 1 to ensure the passage of the 2006 budget in order to fulfill the GOI's commitment to the IMF. (NOTE: The Transitional National Assembly (TNA) passed the budget on December 4. END NOTE.) The Ambassador also pressed the Minister to halt illegal enforcement by Iraq of the Arab League secondary and tertiary boycott of Israel, in order to allow registration of the Pepsi trademark. The Minister said that he expected the budget to pass and that the GOI will meet IMF conditions to allow an IMF Standby Arrangement (SBA) signing later this month. Reform of the State Banks, however, will have to wait until the next government, he said. Allawi was receptive to our Development Fund for Iraq (DFI) proposals, including using them for post-kinetic operations reconstruction. Allawi will not return to the next government and offered views on his possible successors and predictions for the December 15 election. END SUMMARY.

Meeting IMF Requirements

2. (C) The Ambassador, accompanied by the Joint Contracting Command for Iraq and Afghanistan (JCC-I/A) Commanding General, the Economic Deputy-Minister and Treasury Attache, met December 1 with Minister of Finance Ali Allawi to urge him to keep the GOI's 2006 budget on track during TNA debate in order to enable Iraq's IMF precautionary Standby Arrangement (SBA) to be signed o/a December 22. Allawi said that passage of the budget, fuel price increases, the Central Bank audit, and submission of fuel imports liberalization legislation to the TNA will meet the IMF's requirements. He told us that:

-- He had withstood TNA demands to reprogram 50 percent of the national budget to the provincial governates; instead he proposed a 2006 budget that will give the provinces \$1.6 billion vice the original \$1 billion.

-- He will recommend that the next government approve a supplemental budget in 2006 once the Constitution is firmed up.

-- The budget should be approved by the TNA on Sunday, December 4. (NOTE: It was. END NOTE.)

-- Subsidy reform is on track with a range of fuel price increases scheduled to go into effect December 18.

-- The IMF wants the GOI to submit to the TNA and (ideally) pass a fuel imports liberalization law. The bill has been submitted but passage is unlikely.

-- The IMF-required audit of the Central Bank is well underway and should be completed soon.

Banking Reform: "Nothing has been decided"

3. (C) Allawi stressed that "nothing happened" on banking reform on December 1. He said he had hoped for, but did not receive, Council of Ministers authority to let him and the next MinFinance begin the process of reforming Iraq's banking system. Allawi said he has a lot of ideas but that there are "no GOI policies on bank restructuring," that "nothing has been decided," and that this will be an issue for the next government to decide. In light of this, Allawi noted that both he and the Central Bank President were "perplexed" to receive a call from the IMF expressing concern over GOI bank restructuring programs.

PepsiCo and Arab League Boycott

4. (C) The Ambassador urged Allawi to join others in the ITG to find a way to halt illegal enforcement of the Arab League secondary and tertiary boycott, in order to let PepsiCo provide Iraq with badly needed foreign investment (reftel). The Ambassador said that PM Ja'afari supports the idea but,

so as not to go out on a limb, needs support from Cabinet members. The Ambassador emphasized that DPM Chalabi and the Minister of Industry are ready to support the effort. Allawi agreed to work to allow PepsiCo to register its trademark if other Ministers are also on board.

DFI Extension and Post-Kinetic
Operations Reconstruction Funding

15. (C) Allawi agreed to a proposal put forward by JCC-I/A and Treasury Attache asking for an extension of the delegation of authority under which JCC-I/A and the Chief of Mission administer and pay for CPA contracts written against the DFI (the so-called DFI liabilities). Allawi also was agreeable to setting \$150 million from the remaining DFI transition account balance (currently used to cover DFI liabilities) to pay for post-kinetic operations reconstruction needs in cities like Tal Afar and Ramadi.

Future Plans/Next Minister

16. (C) Allawi stressed that he does not want to be in the next government in any capacity. His plan is to return to his private life as soon as the next government is in place. He said that he would not stay on even for one additional year. He revealed that leaders are giving some thought to merging the Ministries of Planning and Finance into a super-Ministry, which could be a political plum for an ambitious politician. (NOTE: Minister of Planning Barham Salih has also suggested that these two Ministries be merged. END NOTE.) He also said that there are a number of capable politicians, businessmen, and technocrats who could replace him as the next Minister of Finance. Possible contenders, he said, include Mohammed Ali Al-Hakim, Muwafaq Al-Ruba'i (National Security Advisor and former business partner of Ali Allawi), Faig Abdul Rasool (Deputy Minister of Planning), and Azez Hassan Jaber (former Deputy Minister of Finance, now an advisor to Deputy President Abdul Mahdi).

Joining the Election Pool

17. (SBU) On the December 15 election, Allawi's predictions are: the Shia Alliance: 115-120 seats ("they'll do better than predicted"); Sunni moderates: 45-50; Kurdish Alliance: 45 seats at first but will increase to 50 when out-of-country votes are counted; and Chalabi: between 5-10 seats. He called former PM Ayad Allawi the "biggest question mark." Minister Allawi expects that 40-50 seats will be determined by undecided Shia voters and that in the end many of these will go to the Shia Alliance. According to Allawi, the Shia Alliance will be charged with forming the first government. He would not predict if the Shia Alliance could form a government within 30 days. Nonetheless, he said he expects there will be many returning faces in whatever government is formed next year.

Comment

19. (C) Allawi will be missed. He has been a driving force in getting the GOI to meet its IMF Emergency Post-Conflict Assistance (EPCA) requirements in order to get an SBA. Without his efforts, the GOI budget would have remained a wishlist for spending oil revenues rather than a serious document based on sound budgeting and accounting procedures. He had hoped that he could start a policy process whereby State Bank reform and restructuring would be considered, but he ran out of time. This will be an issue for the next government to tackle, he told us. Regarding Allawi's idea on merging the Planning and Finance Ministers, we believe that this would be a good idea in the mid-term since the concept of a Minister of Planning is a holdover from previous governments. In the current government, however, we were glad to have had both a Ministry of Finance and a Ministry of Planning because the two men occupying those positions were important promoters of economic reform in Iraq and greater regional and international economic cooperation. END COMMENT.
KHALILZAD